

## ICRA Lanka assigns [SL]B rating to People's Merchant Finance PLC

October 17, 2018

Instrument	Previous Rated Amount (LKR Mn)	Current Rated Amount (LKR Mn)	Rating Action
Issuer rating	N/A	N/A	[SL]B (Stable); assigned

### Rating action

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service, has assigned the issuer rating of [SL]B (Pronounced SL B) with a stable outlook to People's Merchant Finance PLC (PMF or the company).

### Rationale

The rating considers PMF's small scale and franchise, modest asset quality, limited funding diversity & liquidity, poor capital profile and weak profitability indicators. ICRA Lanka takes note of PMF's current shareholding by People's Bank (PB) and People's Leasing and Finance PLC (PLC), which together account for 87.2%. However, PB and PLC shareholding is expected to reduce considerably from current level with the expected capital infusion of LKR 1.5 Bn from a new investor. PMF's core capital as in June 2018 stood modest at LKR 219 Mn, considerably below the regulatory requirement of LKR 1 Bn<sup>1</sup> for Licenced Finance Companies (LFCs). Ability to meet future regulatory capital requirements and improvement in the overall business and financial risk profile would be crucial going forward.

### Outlook: Stable

The outlook may be revised to "Positive" in case of significant improvement in PMF's capital position and improvement in its asset quality and overall financial risk profile. The outlook may be revised to "Negative" in case of PMF continuing to fail in meeting the regulatory capital requirement or in case of further deterioration in its financial risk profile.

### Key rating drivers

**Small scale of operations;** PMF reported a portfolio of 2.7 Bn in Jun-18 and has about 12 branches. The portfolio has remained largely stagnant at current levels over the last 2 years. PMF is primarily into vehicle financing, accounting for 64% (in Jun-18) of the total portfolio, followed by margin trading at 10%, personal loans (including FD backed and others) at 9%, and the remaining includes loans against land, plant and machinery, pawning etc. PMF is expected to focus on vehicle financing going forward and envisages a portfolio of LKR 9.7 Bn by Mar-21; however, this would be contingent on its ability to raise capital and meet all regulatory requirements imposed by CBSL.

<sup>1</sup> LKR 1.5 Bn by Jan-19, LKR 2.0 by Jan-20 and LKR 2.5 Bn by Jan-21

**Modest asset quality;** PMF reported a gross NPA of 9.14% in Jun-18 as compared to 9.83% in Mar-18 (28.11% in Mar-17). Gross NPA of the company improved as a result of LKR 511 Mn write-off made in FY2018. Top 10 NPAs accounted for 60% of the total NPAs in Jun-18 and, most of the NPAs were from the legacy portfolio of the company. Ability to recover from this legacy overdue portfolio and controlling incremental slippages as business expands would be crucial going forward.

**Limited funding diversification and weak liquidity profile:** The company's funding profile is characterised by fixed deposits constituting 91% of its total debt of LKR 2.7 Bn in Jun-18. The company is also presently constrained by regulatory conditions. With most of the deposits being for <1 year, the company is faced with sizeable ALM mismatch of 32% (% of total assets) in <1-year bucket.

**Significant external capital requirement;** PMF's core and total capital adequacy ratios (CAR) stood at 8.06% as of Jun-18. While PMF is complying with the minimum core CAR requirement of 5.00%, its total CAR is below the regulatory threshold of 10.00%. PMF's gearing stood high at 12.3 times in Jun-18. ICRA Lanka expects PMF's capital profile to have further deteriorated with the new CBSL direction on capital adequacy, which came into effect since Jul-18. Further, according to the CBSL direction to LFCs, PMF's core capital is required to be increased to 1.5 Bn by Jan-19, this would thereafter increase by LKR 500 Mn each year to reach LKR 2.5 Bn by Jan-21; PMF's core capital stood at about LKR 219 Mn in Jun-18, below the threshold of LKR 1 Bn as of Jan-18. The company is expected to raise fresh capital from a new investor in the near term, which is crucial from a capitalisation perspective; the company however would need regular external capital infusion to meet future regulatory requirements, if the internal generation does not improve significantly from current levels. ICRA Lanka notes that PB's and PLC's holdings in the company are expected to come down sharply from current levels, post the capital infusion of LKR 1.5 Bn by the new investor.

**Poor profitability indicators:** PMF reported net losses from FY2014 to FY2018. The company reported a modest net profit of LKR 3 Mn (provisional) in Q1FY2019. Going forward, it is crucial to improve PMF's business margins and keep asset quality under control to steadily improve its earnings profile.

**Analytical approach:** For arriving at the ratings, ICRA Lanka has applied its rating methodologies as indicated below.

**Links to applicable criteria:** [ICRA Lanka Credit Rating Methodology for Non-Banking Finance Companies](#)

## **About the company:**

Peoples Merchant Finance was formerly known as Peoples Merchant Bank. The company was incorporated in 1983 as the investment banking arm of Peoples Bank. Subsequently, the company was registered under finance business act and became a licenced finance company in 2012. Peoples Bank and People's Leasing & Finance PLC are the main shareholders with 50.16% and 37.06% shareholding respectively as on date. The company has 12 branches including its head office.

During the year ended March 31, 2018, PMF reported a net loss of LKR 148 Mn on a total asset base of LKR 2.9 Bn as compared to net loss of LKR 199 Mn on a total asset base of LKR 3.5 Bn in the previous fiscal year.

For the three months ended June 2018, the company reported a PAT of LKR 3 Mn on a total asset base of LKR 3.0 Bn.

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